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FISCAL IMPACT STATEMENT

LS 7113 **NOTE PREPARED:** Jan 20, 2006
BILL NUMBER: HB 1332 **BILL AMENDED:** Jan 19, 2006

SUBJECT: Alternative Fuel Production and Use.

FIRST AUTHOR: Rep. Friend **BILL STATUS:** CR Adopted - 1st House
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: For purposes of the Indiana Finance Authority Law, the bill provides that a pollution control facility includes the following: (1) A facility that converts biomass into energy or synthetic gas for beneficial use. (2) Equipment for the conversion of waste tires into energy or synthetic gas for beneficial use. (3) A manufacturing facility that uses certain coal combustion products as a raw material for manufacturing another product.

The bill provides for a deduction against property taxes for organic biomass conversion units and coal conversion systems.

The bill allows a taxpayer that purchases a hybrid vehicle in a retail transaction to claim an Income Tax deduction for the taxable year in which the taxpayer purchases the vehicle. It provides that the amount of the deduction is $1000.

The bill increases the maximum amount of credits that may be granted for biodiesel production, biodiesel blending, and ethanol production. It also extends the tax credit for the retail sale of blended biodiesel to 2010, and eliminates the cap on the maximum amount of credits that may be given.

The bill grants a state tax liability credit for a qualified investment in an E85 base fuel compatible fueling station. It provides that the amount of the credit is equal to the lesser of the following for each E85 base fuel compatible fueling station placed in service by the taxpayer: (1) 50% of the amount of the qualified investment. (2) $2,000.

The bill reduces the Gasoline Tax on E85 base fuel to $0.128 tax rate per gallon.

The bill grants a credit against Excise Tax that otherwise would be imposed on a vehicle capable of using E85 base fuel.

The bill extends the tax credit for integrated coal gasification powerplants to investments in: (1) coal gasification facilities as nonutility boilers or polygeneration; and (2) fluidized combustion bed technologies.

Effective Date: Upon Passage; January 1, 2005 (retroactive); January 1, 2006 (retroactive); March 1, 2006 (retroactive); July 1, 2006; January 1, 2007.

Explanation of State Expenditures: (Revised) ***Indiana Finance Authority (IFA):*** The bill expands the types of pollution control facilities that may be financed by the IFA as part of an industrial development project. Current statute defines a pollution control facility as a facility for the abatement, reduction, or prevention of pollution or for the removal or treatment of any substances in materials being processed that otherwise would cause pollution when used. The term includes the following:

(1) Coal washing, coal cleaning, or coal preparation facilities designed to reduce the sulfur and ash levels of Indiana coal.

(2) Coal-fired boiler facilities designed to reduce emissions while burning Indiana coal.

(3) Pollution control equipment to allow for the environmentally sound use of Indiana coal.

To broaden the types of pollution control facilities that IFA could finance, the bill defines pollution control o include precombustion processes, combustion processes or technology, and postcombustion cleanup. In addition, the bill adds to the definition of a pollution control facility the following:

(1) Facilities that convert biomass, including agricultural waste, industrial waste, and municipal solid waste, into energy or synthetic gas for beneficial use.

(2) Pollution control equipment for the conversion of waste tires into energy or synthetic gas for beneficial use.

(3) Manufacturing facilities that use coal combustion products.

Department of State Revenue (DOR): The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the hybrid vehicle deduction, the tax credit for fueling station investment, and changes to the coal gasification technology investment credit. The DOR also is required to collect recapture taxes from taxpayers receiving refueling station investment credits who convert the property to other uses within three years of receiving the credits. The DOR's current level of resources should be sufficient to implement these administrative tasks.

Explanation of State Revenues: (Revised) ***Hybrid Vehicle Deduction*:** The bill establishes a deduction from Adjusted Gross Income (AGI) for individual and corporate taxpayers that purchase hybrid vehicles. This deduction could potentially reduce AGI tax revenue by $190,000 in FY 2008, with the revenue loss forecast to grow by an average of about 23% per year for five to six years thereafter.

Biodiesel/Ethanol Tax Credits: The bill makes changes to existing tax credits for production of ethanol, biodiesel, and blended biodiesel, and for retail sales of blended biodiesel. The changes are as follows:

(1) The bill increases the aggregate credit limit from $20 M to $50 M for the ethanol production, biodiesel production, and blended biodiesel production credits. The new aggregate limit would apply to all credits provided after December 31, 2004.

(2) The bill increases the taxpayer limits for the ethanol, biodiesel, and blended biodiesel production credits from $3 M to $4 M. In addition, the bill provides that the IEDC may increase the $4 M taxpayer limit to a maximum of $20 M for the ethanol, biodiesel, or blended biodiesel production credits to a taxpayer. Current law allows the IEDC to raise the maximum to $5 M, but only for the ethanol and biodiesel production credits. <u>The amount of additional credits that may be claimed due to the changes in (1) and (2) above is indeterminable and depends on IEDC certification of companies for the production credits.</u> The IEDC certified $12 M in ethanol production credits in 2005 for four companies, with each company receiving $3 M in credits. No more ethanol production credits may be certified under current statute. <u>With the new credit limits, the companies already certified for ethanol production credits could receive at least $1 M each (a total of $4 M in additional credits), and the IEDC could increase credits to these companies by up to $30 M.</u> The IEDC has not certified any credits for biodiesel or blended biodiesel production.

(3) The bill moves the sunset date for the blended biodiesel retail sales credit from December 31, 2006, to December 31, 2010. The bill also eliminates the $1 M credit limit applicable to all taxpayers and all taxable years. <u>The additional credits that might be claimed due both to extending the time frame of the credit and eliminating the credit limit is indeterminable and depends on IEDC certification of sales credits.</u> In 2005, the IEDC did not certify any credits for the retail sale of blended biodiesel.

(Revised) ***Fueling Station Investment Credits:*** The bill establishes a nonrefundable Adjusted Gross Income (AGI) Tax credit for qualified investment in fueling station property in Indiana used to deliver E85 base fuel directly into the fuel system of a motor vehicle used to operate the motor vehicle. The fueling station includes metered pumps, connected storage tanks for the metered pumps, piping, specified site improvements and equipment, and signage. The tax credit is effective for purchase, delivery, installation, and refitting expenses incurred after June 30, 2006, and before January 1, 2011. The property also must be placed in service for the first time in Indiana prior to January 1, 2011, to qualify for the credit. The bill also provides for a clawback of the tax credit if the creditable fueling station property is converted to another use. <u>The amount of fueling station investment credits that may be awarded is indeterminable, and the bill does not place an aggregate limit on credits that may be claimed.</u>

(Revised) ***Coal Gasification Technology Investment Tax Credit:*** The bill extends the current tax credit to new investment in nonutility synthetic gas boilers or polygeneration facilities, and specifies that these facilities maybe for utility or nonutility use. The bill also establishes a separate and smaller tax credit for new investment in fluidized bed combustion technology. These changes could potentially reduce revenue from the Adjusted Gross Income (AGI) Tax, the Financial Institutions Tax, the Insurance Premiums Tax, and the Utility Receipts Tax when a taxpayer undertakes qualified investment in such facilities. <u>The potential amount of tax credits that may be granted as a result of the bill is indeterminable</u> and will depend upon review and approval of creditable investment by the IEDC; and determinations by the IURC that the public convenience and necessity requires the construction of these facilities.

Gasoline Tax: The bill provides for a reduced gasoline tax rate ($0.128 per gallon instead of $0.18 per gallon) on E85 base fuel effective for billed gallonage received in Indiana after June 30, 2006. As current and future E85 usage is unknown, the revenue loss from this rate reduction is indeterminable. However, the would reduce gasoline tax revenue by $0.052 per gallon of E85 used, assuming each gallon of E85 substitutes for a gallon of gasoline that would otherwise be used.

The funds affected by a reduction in gasoline tax revenue are the State Highway Road Construction and Improvement Fund (SHRCIF), State Highway Fund, Motor Vehicle Highway Account (MVHA), and the Highway, Road, and Street Fund (HRSF).

(Revised) ***Motor Vehicle Excise Tax:*** The bill provides a credit against the Motor Vehicle Excise Tax to an owner of a passenger vehicle or truck that is: (1) designed and equipped by the manufacturer to use E85 base fuel and first offered for sale after June 30, 2006; or (2) is converted to use E85 base fuel after June 30, 2006. The credit is equal to the tax amount that would otherwise be imposed for the first year or part of a year that the vehicle is subject to the tax. However, for owners who convert vehicle to E85 base fuel use, the credit is for the year of the conversion provided the vehicle will be used by the owner and not resold during the conversion year. To the extent that E85 passenger cars and trucks replace conventional motor vehicles, there could be a reduction in Motor Vehicle Excise Tax revenue of an indeterminable amount.

State Property Tax: The bill establishes annual AV deductions for "organic waste biomass conversion units" and "coal conversion systems." (Definitions for these terms are provided below under Explanation of Local Revenues.) Property tax deductions exclude property from the property tax base. The state levies a small tax rate for the State Fair and State Forestry Funds that applies to all AV. If property is not a part of the tax base, the state cannot assess this tax on the property. Any decrease in the AV base as a result of deductions reduces the property tax revenue collected for these two funds.

Background: (Revised) Hybrid Vehicle Deduction: The bill establishes a deduction from Adjusted Gross Income (AGI) for individual and corporate taxpayers that make a retail purchase of a new hybrid vehicle. The deduction is equal to $1,000 per hybrid vehicle purchased by the taxpayer during the taxable year. The bill disallows the deduction if the vehicle was purchased at wholesale for the purpose of resale; or was purchased at retail from a person who already purchased the vehicle in a retail transaction. The bill defines a "hybrid vehicle" as a motor vehicle that: (1) draws propulsion energy from both an internal combustion engine and an energy storage device; and (2) uses a regenerative braking system to recover waste energy to charge the energy storage device that is providing propulsion energy.

The estimated revenue impact is based on: (1) the Indiana share of new hybrid vehicles registered nationally in 2003; and (2) forecast annual hybrid vehicle sales totals for the period 2007 to 2011. Survey data on new hybrid vehicle registrations by state is generated by R. L. Polk and Company. This survey information suggests that the Indiana share could potentially be 1% or somewhat less in the near future. The Office for the Study of Automotive Transportation is currently forecasting 2011 sales of about 1.3 million units nationally, up from 88,000 units in 2004. The estimated deduction amounts assume a blended tax rate of about 4.7%, assuming about 75% of the impact will be from individual filers.

Biodiesel/Ethanol Tax Credits: Current statute provides credits against a taxpayer's Sales and Use Tax, AGI Tax, Financial Institutions Tax, or Insurance Premiums Tax liability for the production of biodiesel, blended biodiesel, and ethanol, and for the retail sale of blended biodiesel. The tax credits are: (1) $1.00 for each gallon of biodiesel manufactured in Indiana and used to produce blended biodiesel; (2) $0.02 per gallon of blended biodiesel produced in Indiana using biodiesel produced in Indiana; (3) $0.125 per gallon of ethanol produced at an eligible facility in Indiana; and (4) $0.01 per gallon of blended biodiesel sold by Indiana retailers.

Current statute limits the ethanol, biodiesel, and blended biodiesel production credits combined to $20 M for all taxpayers and all taxable years. Within this overall limit, the credits certified by the IEDC must total at least $4 M for each credit. Thus, no new credits for ethanol production can be approved under the current limits, as the IEDC certified $12 M in ethanol production credits in 2005 ($3 M each to four companies). In addition, the taxpayer limit for each credit is $3 M, with provision for the IEDC to increase this limit to $5 M for the ethanol production credit or the biodiesel production credit.

The Alternative Fuels Association (AFA) reports that one ethanol production facility currently operates in Indiana with a capacity of 102 million gallons per year. The AFA also reports that two facilities are currently under construction in Indiana, each with a 40 million gallon annual capacity. The National Biodiesel Board (NBB) reports that there are currently 45 active biodiesel production plants operating in the U.S. and 53 additional production plants proposed, including two in Indiana. The NBB reports that dedicated biodiesel plants in the U.S. have a total capacity of 60 to 80 million gallons per year, and that an additional 200 million gallons of capacity are available from non-dedicated facilities operated by oleochemical producers. The NBB also reports that a total of 59 biodiesel retailers and 41 biodiesel distributors currently operate in Indiana.

(Revised) Fueling Station Investment Credits: The credit is equal to the lesser of (1) 50% of the qualified investment or (2) $2,000, and may be claimed only in the taxable year in which the fueling station property is placed in service. E85 fuel contains 85% ethanol and 15% gasoline, while B20 contains 20% biodiesel and 80% petroleum diesel. The bill requires that fueling stations eligible for the investment credit to be located at a retail outlet. The bill requires a credit recipient to pay a recapture tax to the Department of State Revenue if the fueling station property that is the basis for the credit is converted to another use within three years of the taxable year the property was placed in service. The recapture tax is equal to 75% of the credit if the conversion takes place within one year of the tax year the property was placed in service; 50% of the credit if conversion takes place within two years; and 25% if the conversion takes place within three years.

(Revised) Coal Gasification Technology Investment Tax Credit: The current tax credit may be taken against a taxpayer's tax liability arising under the AGI Tax, Financial Institutions Tax, Insurance Premiums Tax, and Utility Receipts Tax for qualified investment in an integrated coal gasification power plant. The credit is equal to 10% of the first $500 M in qualified investment, and 5% of the qualified investment exceeding $500 M. The bill extends this tax credit to qualified investment in nonutility boilers and polygeneration facilities. While the bill allows the credit for such facilities whether constructed for utility or nonutility use, it prohibits the portion of the credit for investment exceeding $500 M, if the facility is not dedicated primarily to serving Indiana retail electric utility consumers.

The bill also establishes a small tax credit for qualified investment in fluidized bed combustion technology. This credit would be equal to 7% of the first $500 M in qualified investment, and 3% of the qualified investment exceeding $500 M. The bill also requires credit recipients for investment in: (1) a facility primarily serving Indiana retail electric utility consumers to use 100% Indiana coal at the facility; and (2) a facility not dedicate to Indiana retail electric utility consumers to use 75% Indiana coal at the facility.

Under current statute unchanged by the bill, a taxpayer may take the credit in 10 annual installments beginning with the year in which the taxpayer places the integrated coal gasification power plant into service. The annual credit installment that a taxpayer may claim is equal the lesser of the percentage of the coal utilized during the taxable year in the facility that is Indiana coal multiplied by: (1) 10% of the total credit amount; or (2) the greater of (a) 25% of the taxpayer's total state tax liability for the taxable year or (b) the taxpayer's Utility Receipts Tax liability for the taxable year.

Explanation of Local Expenditures:

Explanation of Local Revenues: ***Property Tax Deductions:*** The bill establishes assessed value (AV) deductions for "organic waste biomass conversion units" and for "coal conversion systems." The annual deduction for organic waste biomass conversion units is equal to the difference between the AV of the taxpayer's property, including the AV of the organic waste biomass conversion unit; minus the AV of the taxpayer's property, excluding the AV of the organic waste biomass conversion unit. The annual deduction for coal conversion systems is equal to 95% of the AV of the system multiplied by the proportion of the coal converted by the system during the preceding year that was Indiana coal. These deductions apply to property taxes first due and payable after December 31, 2006. Taxpayers must apply for the deduction in the same manner provided under current statute for the AV deduction for wind power devices.

Additional deductions reduce the AV tax base. This reduction causes a shift of the property tax burden from the taxpayers receiving the deductions to all taxpayers in the form of an increased tax rate. The amount of the deductions is indeterminable. Total local revenues would not be affected, except that the revenue in rate-controlled funds would be reduced.

An "organic waste biomass conversion unit" is tangible property directly used to produce gas or electricity from agricultural livestock waste nutrients or other agriculture sources, including orchard tree crops, vineyard, grain, legumes, sugar, and other crop byproducts or residues. However, an organic waste biomass conversion unit does not include tangible property that uses fossil fuel that exceeds the minimum amount of fossil fuel required for any necessary startup and flame stabilization or municipal solid waste.

A "coal conversion system" means tangible property directly used to convert coal into a gaseous or liquid fuel or char, including coal liquification, gasification, pyrolysis, and a fluid bed combustion system designed for pollution control.

Hybrid Vehicle Deduction: Because the AGI deduction for retail purchases of hybrid vehicles proposed in the bill would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

Motor Vehicle Excise Tax: Revenues from the tax are allocated to the taxing district in which the registrant resides. Allocations could be affected in districts where E85 passenger cars and trucks are registered.

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation; Department of Local Government Finance; State Fair; State Forestry; Indiana Utility Regulatory Commission; Indiana Department of Transportation; Indiana Finance Authority.

Local Agencies Affected: All. Counties with a local option income tax.

Information Sources: Hybrid registrations data from R. L. Polk & Company at http://www.polk.com. Hybrid sales forecast from Office for the Study of Automotive Transportation, Transportation Research Institute, University of Michigan. *Estimates of Federal Tax Expenditures for Fiscal Years 2004-2008*, Joint Committee on Taxation. Gretchen White, Indiana Economic Development Corporation, (317) 234-3997

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